M e m o r a n d u m

330.2522.600

To: Bakersfield Audit (WL) June 30, 1986

From: Teresa Armstrong

Subject: Equipment Leases – T--- B---, Lessee
SR -- XX XXXXXX

B--- T---, Inc., Lessor
SR -- XX XXXXXX

This is in response to your memorandum of May 12, 1986 concerning two leases between B--- T--- and T--- B---. Your question concerning both leasing transactions is whether or not they constitute present sales of tangible personal property.

The first lease is a fixed term five-year lease for the rental of 16 trucks and miscellaneous office equipment with a combined value of approximately $231,000. The lease calls for monthly payments of $4,537.65. By the terms of the contract, title to the equipment is to remain in the lessor. With the lease agreement there is an option to purchase the equipment which may be exercised during the last six months of the lease term. However, the option purchase price of $23,189 is required to be paid in cash at the time of the execution of the lease agreement.

The written lease agreement executed by the parties is structured to have the appearance of a true leasing transaction. However, we must conclude that the first lease is in fact a sale of tangible personal property. A lease in which the price of the option to purchase is nominal, will be treated as a present sale of tangible personal property for the purposes of Sales and Use Tax Law. Pursuant to Regulation 1660(a), an option purchase price is deemed to be nominal if the option price does not exceed $100 or one percent of the total contract price, whichever is lesser.

In the first lease, the option price is $23,189 or approximately 10 percent of the value of the property. While this option price is more than a nominal amount, the requirement that the purchase price be paid in advance in effect renders the true option price to be paid at the end of the lease to be zero dollars. In other words, at the end of the lease term the only requirement to exercise the option will be for the lessee to give written notice to the lessor. Additionally, the parties themselves are treating the transaction as a sale. This is reflected by the lessee depreciating the equipment on his federal income tax returns. As further authority for our position that the lease constitutes a present sale, Regulation 1641(b) provides that if tangible personal property is for all intents and purposes sold, but is treated as a leasing agreement for the purpose of retaining title in the seller as security for payment of the purchase price or for the purposes of avoiding tax, the transaction is deemed to be taxable as a sale under a security agreement. We therefore conclude that the first lease between the parties constitutes a present sale of the tangible personal property listed in the agreement.

The second lease is for a fixed term of 37 months with rental payments of $3,100 per month. The agreement contains a title clause whereby all right, title and interest in the equipment is retained by the lessor. However, the lessee has the option to purchase the equipment during the last six months of the lease term upon payment of an option purchase price of $100. As stated previously, Regulation 1660(a) treats leasing agreements with nominal option purchase prices of $100 as a present sale of tangible personal property. The second lease is also taxable as a present sale.

TA:ba